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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Petition for Expedited	)	CC Docket No. 98-5
Declaratory Rulings	)	

COMMENTS OF U S WEST, INC.

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SUMMARY

U S WEST, Inc. ("U S WEST") is eager to provide interLATA services to residential and business customers within its 14 Western and Midwestern states. While LCI International Telecom Corp. ("LCI") contends that its proposal, if implemented by a Bell Operating Company ("BOC"), would result in a presumption that the BOC has met the competitive checklist and the public interest test in Section 271 of the Telecommunications Act of 1996 ("1996 Act"), it is unlikely that LCI's proposal would facilitate BOC entry into the interLATA market.

LCI's proposal would deprive BOCs and their public shareholders of the right to make critical business and financial choices about how they will structure and conduct their business, while interexchange carriers and new entrants in the local market would continue to enjoy those rights. LCI's proposal also alters Sections 251, 252, 271, and 272 of the 1996 Act by imposing new substantive requirements which exceed the Federal Communications Commission's ("Commission") authority. LCI's proposal would result in dramatically higher costs to the BOC, to new entrants, and to customers. The proposal also represents bad public policy, because it is based upon a flawed assumption that the present corporate structure of the BOCs will render them incapable of demonstrating compliance with the checklist requirements and the public interest test. Finally, LCI's proposal would result in an industry structure which is inconsistent with Congressional intent and it would lead to the elimination of resale as one of the paths by which new entrants could enter the local market. These infirmities are fatal to LCI's proposal.

Even if LCI's proposal were not fundamentally flawed, LCI is unwilling to give any assurance to a BOC who chooses to implement the proposal that LCI would agree not to oppose the BOC's application to provide in-region interLATA services. At most, LCI would regard implementation of its proposal as resulting in only a rebuttable presumption that the BOC has met the checklist and the public interest test. In so doing, LCI preserves its right to oppose a BOC's 271 application and to further delay a BOC's entry into the interLATA market even after the substantial delay which will be caused by the massive restructuring effort called for in LCI's plan.

For BOCs who choose not to implement LCI's proposal, the Commission can never use LCI's proposed plan as a de facto standard to determine whether they have met the checklist and the public interest test. Such an attempt would exceed the Commission's authority and violate the 8th Circuit Court of Appeals recent orders.

LCI's proposal is ill-advised and, if endorsed by the Commission, it will not withstand judicial scrutiny.

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COMMENTS OF U S WEST, INC.

U S WEST, Inc. ("U S WEST") hereby submits comments to the Petition filed by LCI International Telecom Corp. ("LCI") for expedited declaratory rulings to establish structural and transactional separation requirements for Bell Operating Companies ("BOC") who seek authorization to provide in-region interLATA services in their states.[1]

I. INTRODUCTION

U S WEST is pleased that LCI advocates that the BOCs should be permitted to enter the interLATA market as soon as possible. However, LCI's proposal would result in a proliferation of new corporate entities which is inconsistent with the structure for the telecommunications industry envisioned by Congress when it enacted the Telecommunications Act of 1996 ("1996 Act"). Moreover, in a number of instances, LCI's proposal is in direct conflict with Congressional requirements in

[1] Petition of LCI International Telecom Corp. for Expedited Declaratory Rulings, CC Docket No. 98-5, filed Jan. 22, 1998 ("LCI Petition"). Public Notice, Commission Seeks Comment on LCI Petition for Declaratory Ruling Concerning Bell Operating Company Entry Into In-Region Long Distance Markets, DA 98-130, rel. Jan. 26, 1998; Order extending deadline for filing reply comments, DA 98-339, rel. Feb. 20, 1998.

the 1996 Act and, if implemented by a BOC would eliminate resellers from the local market. Although U S WEST welcomes LCI's efforts to facilitate BOC entry into the interLATA market, LCI's proposal does not offer any assurance that that goal will be achieved.[2]

II. LCI'S PROPOSAL IS A CONTRIVED MODEL WHICH DEPRIVES THE BOCS OF THEIR RIGHT TO MAKE FUNDAMENTAL BUSINESS AND FINANCIAL CHOICES FOR THEMSELVES

Congress designed Sections 251 and 252 of the 1996 Act to provide new entrants with choices for entering the local market. They have the ability to determine the structure of their business, to select the geographic and customer markets they wish to enter, and the services they wish to offer.

For those entrants who choose to enter the local market, they have the option to use their own wireline or wireless facilities and to interconnect with the BOC's network, to resell BOC retail services, to purchase BOC unbundled network elements ("UNE"), or to utilize any combination of these.

[2] LCI calls its proposal "Fast Track." However, that is a misnomer, because it implies that the process in Sections 271 and 272 which requires the Commission to act in only 90 days on a BOC's application to provide interLATA services is the "Slow Track." Moreover, LCI's Petition is based upon the false assumption that the BOCs are incapable of achieving checklist compliance without implementing its proposal. However, the Commission has put in place a series of meetings and informal discussions with each BOC and interested persons in which it will provide informal preliminary guidance to each BOC and facilitate the resolution of issues under Section 271 with the goal of accelerating the BOCs' ability to receive approval of their Section 271 applications. Public Notice, Common Carrier Bureau Announces Meetings on Section 271 of the Communications Act, DA 98-139, rel. Jan. 27, 1998. Such action provides more demonstrable evidence than LCI's proposal that the Commission intends to take a pragmatic and business-like approach to checklist compliance.

Interexchange carriers ("IXC") who currently offer long distance services have even more choices. They have the option to choose not to enter the local market, to maintain their current business structure and customer base, and to oppose efforts by a BOC to become their competitor in the interLATA market.

For IXCs who choose to enter the local market, they have the right to choose when and where to enter the market[3] and to determine the structure of their business which may include: (i) positioning their local service and long distance businesses as services of a single corporate entity; (ii) establishing different operating divisions for local service and long distance service; or (iii) creating structurally separate entities to provide local service and long distance service. In addition, many IXCs also offer both wholesale and retail long distance services and they enjoy the business flexibility today of offering these services through the same corporate entity.[4]

The organization and market strategies are left to the business judgment of the new entrant. There is no "one size fits all." The ability to exercise these

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[3] LCI says that it "is committed to compete in the local market, including extending new local service choices to its millions of residential customers." LCI Petition at 2. U S WEST concedes that LCI offers 1+ interLATA service to customers within U S WEST's 14-state region. However, as of this date, LCI has not made a request to U S WEST to negotiate an agreement for interconnection, services, or network elements for purposes of offering local service.

[4] When a BOC obtains relief and begins to offer in-region interLATA service, it is likely that most BOCs will do so by purchasing wholesale interLATA services from an IXC and reselling them in competition with that IXC and others. The legal and public policy basis for LCI's proposal is its belief that the provision of wholesale and retail services by an integrated entity creates an inherent "conflict of interest" requiring structural separation. Id. at 11-12. If LCI's premise is correct, then it

choices, and to structure their business, their services, and their business plans as they choose, are fundamental rights which Congress preserved for new entrants such as LCI.

On the other hand, LCI's proposal deprives a BOC of the same right to make those business choices. Existing BOC end-user customers could continue to receive local service from NetCo, the former BOC.[5] However, new customers would be unable to obtain service from NetCo.[6] They would be required to obtain local service from a new entity, ServCo,[7] or from other new entrants who choose to offer local service. Moreover, end-user customers who currently receive local service from NetCo would be unable to continue to purchase the same service from NetCo if they move to a new house directly next door to their current residence;[8] they would be required to change providers and to purchase local service from ServCo or from another new provider, if any, of local service on that block. At some point, all of NetCo's end-user customers would be "assigned" to other providers of local service through balloting and allocation.[9] Finally, to compound customer confusion and dismay over who they are allowed to purchase local service from, LCI says that "NetCo and ServCo must operate under materially different trade names and

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follows that IXCs who offer both retail and wholesale interLATA services face the same conflict of interest which must be remedied by IXC structural separation.

[5] Id. at 15. NetCo would also provide wholesale services to new entrants. NetCo is the name LCI assigns to the separate wholesale company subsidiary.

[6] Id. ServCo is the name LCI assigns to the separate retail company subsidiary.

[7] Id.

[8] Id. at 18.

service marks that do not reflect any affiliation"[10] to ensure that end-user customers do not see any historical or business linkage between NetCo and ServCo and the types and quality of service customers expect from their telephone company.

LCI's proposal also requires a BOC to incur at least the following new and additional costs and expenses: (1) organizing costs and expenses to establish two separate corporate entities, NetCo and ServCo; (2) securities underwriting and reporting costs to obtain new public shareholders for NetCo;[11] (3) substantial new capital expenditures and operating expenses to establish and operate the new retail company, ServCo;[12] (4) indeterminable costs for NetCo to obsolete current systems and to design and develop all new ordering, provisioning, repair and maintenance, and billing systems for new entrants.[13]

If a BOC chooses to implement the structural and transactional separation requirements of LCI's proposal,[14] LCI says that it would only establish a "rebuttable presumption" that the BOC has met the competitive checklist and the public

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[9] Id.

[10] Id. at 21.

[11] LCI would require ServCo to have public ownership of at least 40%. Id. at 17.

[12] ServCo could not share "equipment, buildings, services, or other resources" with NetCo. Id.

[13] See Section V. infra.

[14] LCI confirms that a BOC's choices would be limited when it says that a BOC would not have the option to select from among the requirements in its proposal, which LCI loosely refers to as "the seven minimum elements." "We emphasize that the 'seven minimums' are entirely indivisible; if one is missing the others are not effective." LCI Petition at 28.

interest test of Section 271.[15]

No assurance is offered by LCI that such a presumption would result in a Commission finding that the BOC has met the checklist or that the Commission would grant the BOC's application to provide in-region interLATA services. The price which LCI proposes to exact from the BOCs is at least two-fold: (1) the imposition of significant costs and expenses to establish, finance, fund, and operate new corporate entities; and (2) confusion among a BOC's retail customers when they are told that they may no longer continue to receive local service from the company from whom they have been receiving local service (i.e., NetCo) and that they must select another local provider or, when they fail or refuse to select another provider, that they will be "assigned" to one.

Even assuming that a BOC would knowingly and willing accept the serious, and perhaps irreparable, damage to its retail and wholesale businesses by implementing LCI's proposal with the expectation that it could offset the loss of customers and revenues with a new interLATA business, LCI offers no assurance that the BOC will obtain interLATA relief.[16] Rather, LCI preserves the right of all new entrants and IXCs to attack the rebuttable presumption and to continue to oppose the BOC's Section 271 application before the Commission and the D.C. Circuit Court on appeal. In the meantime, the BOC, who has incurred the cost and

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[15] Id. at 14, 24.

[16] LCI offers only the following guarded and ambiguous statement: "If the [Regional Bell Operating Company] RBOC is willing to go a step further in a manner that fundamentally alters its incentives [i.e., implement LCI's proposal], then it will

expense of implementing LCI's proposal and who has lost and may continue to lose local retail customers and revenues, continues to be prohibited from offering interLATA services.

LCI's proposal deprives a BOC of the ability to make fundamental business choices which new entrants and IXCs enjoy today under the 1996 Act. And it is not clear that interLATA relief will necessarily follow from implementation of LCI's plan.

III. LCI'S PROPOSAL ALTERS THE SUBSTANTIVE REQUIREMENTS OF THE 1996 ACT

In making its proposal, LCI says that it "is not proposing any change in the substantive requirements of the Act."[17] LCI says that BOCs must still comply with the requirements in Sections 271 and 272 before they obtain interLATA authorization and Section 251 still applies.[18]

U S WEST disagrees with the claim that LCI's plan does not change substantive requirements in the 1996 Act. It changes substantive requirements in both Sections 251 and 272.

A. Section 251

LCI's plan imposes the following additional substantive requirements which have been determined by the 8th Circuit Court of Appeals not to be requirements under Section 251:

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obtain additional benefits, which benefits ultimately would inure to consumers as well." Id. at 26-27.

[17] Id. at 36.

[18] Id.

(1) Rebundling Network Elements

LCI criticizes the RBOCs for being unwilling to provide UNEs "in the manner requested by the [competitive local exchange carriers] CLECs."[19] Specifically, LCI complains that the RBOCs refuse to "do the combining" of UNEs, that the RBOCs "uncombine" existing combinations of network elements,[20] and that the RBOCs refuse to permit CLECs to purchase a "platform" configuration of recombined network elements.[21] Accordingly, under LCI's plan, NetCo which would provide wholesale local network operations would be "obligated to provide combinations of network elements on a prompt and efficient basis . . . ."[22]

The 8th Circuit Court of Appeals addressed this issue and said that Section 251(c)(3) of the 1996 Act does not require an incumbent local exchange carrier ("ILEC") to do the rebundling or recombining:

> We also believe that the FCC's rule requiring incumbent LECs, rather than the requesting carriers, to recombine network elements that are purchased by the requesting carriers on an unbundled basis, 47 C.F.R. § 51.315(c)-(f), cannot be squared with the terms of subsection 251(c)(3). The last sentence of subsection 251(c)(3) reads, "An incumbent local exchange carrier shall provide such unbundled network elements in a manner that allows <u>requesting carriers to combine</u> such elements in order to provide such telecommunications service." This sentence unambiguously indicates that requesting carriers will combine the unbundled elements themselves. While the Act requires incumbent LECs to provide elements in a manner that enables the competing carriers to combine them, unlike the Commission, we do not believe that this language can be read to levy a duty on the incumbent LECs to do the actual combining of elements. . .

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[19] <u>Id.</u> at 7.

[20] <u>Id.</u> at 8.

[21] <u>Id.</u> at 7.

[22] <u>Id.</u> at 19.

> Despite the Commission's arguments, the plain meaning of the Act indicates that the requesting carriers will combine the unbundled elements themselves; the Act does not require the incumbent LECs to do all of the work.[23]

The Court also addressed whether the BOCs have a duty under Section 251 to offer an existing "platform" of combined network elements:

> [Section] 251(c)(3) does not permit a new entrant to purchase the incumbent LEC's assembled platform(s) of combined network elements (or any lesser existing combination of two or more elements) in order to offer competitive telecommunications services.[24]

LCI's proposal would require the BOCs to do what the 8th Circuit said they are not required to do under Section 251(c)(3). LCI's claim that its plan is merely voluntary or optional with the BOCs is disingenuous, because it "requires" a BOC to offer to do what the 1996 Act does not require as part of the price for obtaining interLATA relief.

(2) Pick and Choose

Under LCI's proposal, NetCo would be subject to the requirement in Section 252 to negotiate agreements to provide access and interconnection. However, LCI imposes additional requirements not mandated by the 1996 Act: NetCo's interconnection agreements must be documented in tariffs and they must be subject to a pick-and-choose rule.[25] Again, LCI asks the Commission to adopt a requirement

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[23] Iowa Utilities Bd. v. FCC, 120 F.3d 753, 813 (1997), as amended on reh'g, Oct. 14, 1997 (citations omitted, emphasis in original) ("8th Circuit Order"); pet. for stay granted, 109 F.3d 418; pets. for writ of cert. pending, S.Ct. Nos. 97-826, et al., conditional cross-pets. for writ of cert. pending, S.Ct. Nos. 97-1075, et al.

[24] Id.

[25] LCI Petition at 21.

which the 8th Circuit Court of Appeals has said Section 252 of the 1996 Act does not require:

> The structure of the Act reveals the Congress's preference for voluntarily negotiated interconnection agreements between incumbent LECs and their competitors over arbitrated agreements.[26]
>
> The FCC's "pick and choose" rule, however, would thwart the negotiation process and preclude the attainment of binding negotiated agreements. . . . [T]he FCC's rule would discourage the give-and-take process that is essential to successful negotiations. Moreover, negotiated agreements will, in reality, not be binding, because, according to the FCC, an entrant who is an original party to an agreement may unilaterally incorporate more advantageous provisions contained in subsequent agreements negotiated by other carriers. This result conflicts with the Act's requirement that agreements be "binding."[27]

LCI's plan incorporates requirements which the 8th Circuit Court has expressly found cannot be imposed by the Commission as requirements under the 1996 Act. And it is no defense to say, as LCI does, that these requirements would merely be optional or voluntary. To the extent a BOC chooses to implement LCI's plan, the "seven minimum requirements" would be mandatory as a matter of law because, as LCI says: "We emphasize that the 'seven minimums' are entirely indivisible; if one is missing the others are not effective."[28]

The 8th Circuit Court's admonition to the Commission about the vacated pricing rules would also apply to the Commission's attempt to enforce these new substantive requirements if a BOC chose to implement LCI's proposal as a

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[26] 8th Circuit Order, 120 F.3d at 801.

[27] Id. (citation omitted).

[28] LCI Petition at 28.

condition to obtaining interLATA relief:

> This attempt to reassert the vacated pricing rules by imposing them as conditions for entry by the Bell Operating Companies into the in-region, interLATA telecommunications business does by indirection what we told the FCC in Iowa Utils. Bd. it could not do. The FCC cannot do in an advisory opinion in a ruling on a section 271 application that which we have expressly forbidden it from doing in its rule-making procedure. A more clear violation of our mandate could hardly be imagined.[29]

The Commission cannot enforce these substantive requirements by asserting that the requirements are merely voluntary or optional with the BOC. LCI makes it clear that they are mandatory for BOCs who choose to proceed under LCI's plan and the requirements will be enforced by the Commission for BOCs who say that they wish to proceed under LCI's proposal.

B. Section 272

LCI's plan also changes the substantive law under Section 272 by imposing new requirements:

(1) Trade Names and Service Marks

Under LCI's proposal, NetCo, which would provide wholesale local services, and ServCo, which would provide retail local services and interLATA service, would both be subsidiaries of a holding company, HoldCo. However, they would be required to use different trade names and service mark which do not reflect any corporate or business affiliation.[30] This represents a new substantive requirement not found in Section 272 of the

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[29] Iowa Utils. Bd. v. FCC, Order On Motions for Enforcement of the Mandate, No. 96-3321, Jan. 22, 1998, as corrected, Jan. 23, 1998 ("Enforcement Order") at 6.

1996 Act.

The only remotely related requirement is found in Section 274[31] dealing with a BOC affiliate who is engaged in electronic publishing. Section 274(b)(6)[32] provides that an electronic publishing affiliate may not use for marketing its products and services the name, trademarks, or service marks of an existing BOC; however, if the names and marks are owned by an entity that owns or controls the BOC, i.e., a parent or holding company, the prohibition does not apply.

LCI's proposal creates a new substantive requirement and prohibition which, under the corporate structures proposed by LCI, the 1996 Act does not require and which the 1996 Act in fact expressly permits.

(2) Shared Services and Facilities

Under LCI's proposal, ServCo, which would provide retail services, could not share equipment, buildings, or services with its holding company parent, HoldCo, or with its sister company NetCo.[33] LCI says that ServCo would be subject not only to the structural and transactional separation requirements in LCI's plan but also to the structural and transactional separation requirements in Section 272, because in addition to providing retail local services ServCo would be the Section 272 interLATA affiliate.

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[30] LCI Petition at 21.

[31] 47 U.S.C. § 274.

[32] 47 U.S.C. § 274(b)(6).

[33] LCI Petition at 17.

LCI's proposal imposes separation requirements which are more onerous than the separation requirements imposed by Section 272 or by the Commission. When the Commission considered the issue of shared services and facilities between a BOC and its Section 272 affiliate, the Commission acknowledged that the two were required to operate independently. However, the Commission said:

> [W]e decline to read the "operate independently" requirement to impose a prohibition on all shared services. We recognize the inherent tension between the "operate independently" requirement and allowing the integration of services. As we discuss further below, however, we believe the economic benefits to consumers from allowing a BOC and its section 272 affiliate to derive the economies of scale and scope inherent in the integration of some services outweigh any potential for competitive harm created thereby. Therefore, we permit the sharing of administrative and other services.[34]
>
> [W]e decline to read the "operate independently" requirement to impose a blanket prohibition on joint ownership of property by a BOC and a section 272 affiliate. Rather, we limit the restriction to joint ownership of transmission and switching facilities and the land and buildings where those facilities are located. . . . We find that joint ownership of other property, such as office space and equipment used for marketing or the provision of administrative services, may provide economies of scale and scope without creating the same potential for discrimination by the BOCs.[35]

LCI's plan to prohibit ServeCo from sharing equipment, buildings, or services

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[34] In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, First Report and Order, 11 FCC Rcd. 21905, 21986 ¶ 168 (1996) ("First Report and Order"), pet. for summary review denied in part and motion for voluntary remand granted, Bell Atlantic v. FCC, No. 97-1067 (D.C. Cir.), pet. for rev. in abeyance sub nom. SBC Communications v. FCC, No. 97-1118 (D.C. Cir.); on recon., 12 FCC Rcd. 2297 (1997); on further recon., 12 FCC Rcd. 8653 (1997), pets. for review, denied, Bell Atl. Tel. Cos. v. FCC, 131 F.3d 1044 (1997).

[35] First Report and Order, 11 FCC Rcd. at 21983-984 ¶ 162.

with HoldCo or with NetCo imposes a blanket separation requirement on these entities, is more severe than the Commission found to be necessary when it recently considered the issue, and in fact changes the substantive requirements under Section 272, notwithstanding LCI's claim that its plan does not alter or change any substantive requirements in the 1996 Act.

U S WEST objects to the attempt to impose these changes to the 1996 Act as new requirements on a BOC which chooses to proceed under LCI's plan, because they have not been adopted by Congress and they are in direct opposition to Orders entered by the 8th Circuit Court. LCI and the Commission do not avoid these legal infirmities by calling the new requirements merely optional or voluntary and, therefore, not really requirements imposed on a BOC by the Commission. As the 8th Circuit Court said: "The FCC may not accomplish indirectly that which we have held it may not do directly."[36]

Even assuming, arguendo, that the requirements in LCI's plan are only optional or voluntary and are not mandatory requirements imposed by the Commission, the Commission plainly exceeds its authority if it signals that LCI's proposed requirements represent the de facto standard for all BOCs who attempt to comply with the checklist and the public interest test, even if a BOC chooses not to implement LCI's proposal. LCI's proposed requirements cannot be used by the Commission to coerce or intimidate the BOCs who reject LCI's plan to implement all of LCI's proposed requirements. The 8th Circuit Court rejected what it regarded

[36] Enforcement Order at 11.

as a similar attempt to intimidate state commissions into complying with the substance of the FCC's pricing rules which the Court had earlier vacated.[37] If the Commission attempts, directly or indirectly, to use LCI's proposed requirements as a standard for all BOCs which seek interLATA relief, the Commission will open itself to judicial challenges of its orders on Section 271 applications on new grounds, and it will result in more delay for the BOCs in obtaining interLATA relief.

IV. LCI'S PROPOSAL WOULD RESULT IN THE ELIMINATION OF ONE OF THE PATHS BY WHICH NEW ENTRANTS CAN ENTER OR REMAIN IN THE LOCAL MARKET

The Commission has recognized that new entrants have three paths under the 1996 Act to enter the local market:

> It is essential for local competition that the various methods of entry into the local telecommunications market contemplated by the Act -- construction of new facilities, purchase of unbundled network elements, and resale -- be truly available. Therefore, an open local market is one in which, among other things, new entrants have nondiscriminatory access to interconnection, transport and termination, and unbundled network elements at prices based on forward-looking economic costs, and the opportunity to obtain retail services at an appropriate discount for resale.[38]

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[37] Id. at 14-15.

[38] In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as Amended, to Provide In-Region, InterLATA Services in Michigan, Memorandum Opinion and Order, 9 Comm. Reg. (P&F) 267, 276 ¶ 21 (1997) ("Michigan Order"). See also, In the Matter of Application of BellSouth Corp., et al. Pursuant to Section 271 of the Communications Act of 1934, as Amended, to Provide In-Region, InterLATA Services in South Carolina, CC Docket 97-208, Memorandum Opinion and Order, FCC 97-418, rel. Dec. 24, 1997 ("South Carolina Order") ¶ 10, appeal pending sub nom. BellSouth Corporation, et al. v. FCC, No. 98-1019 (D.C. Cir.): "Section 251 of the 1996 Act contemplates three paths of entry into the local market -- the construction of new networks, the use of unbundled elements of the incumbent's network, and resale."

LCI's proposal, if it were implemented by a BOC, would favor facilities-based providers of local service, who either construct their own facilities or purchase UNEs, and would disadvantage non-facilities-based providers such as resellers. LCI's proposal would ultimately force resellers out of the market, because it would result in the elimination of resale as a viable method for new competitors to provide service in the local market.

The Commission recognized that the resale duty imposed upon ILECs in Section 251(c)(4) establishes an "essential" path to enter the local market. That duty requires an ILEC "to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers."[39]

Under LCI's proposal, NetCo would be the wholesale provider of services to carriers as well as an interim retail provider to the BOC's existing customer base on a transition basis, it would be regulated as an ILEC, and it would be subject to all of the duties under Sections 251 and 252.[40] During the short transition period when NetCo would continue to provide telecommunications services at retail to end-user customers, new entrants would have the right under Section 251(c)(4) to obtain those same services from NetCo at wholesale rates for resale.

However, shortly after implementing LCI's proposal, NetCo would be required to cease offering retail telecommunications services to end-user customers. Under its proposal, LCI says that NetCo's existing base of retail customers will be

[39] 47 U.S.C. § 251(c)(4)(A).

required to select another local provider through balloting or by assignment to another carrier. After it loses its retail customers, NetCo's customers would become carriers exclusively. "At that point, NetCo would be a pure 'carrier's-carrier.'"[41]

Under LCI's proposal, the retail provider would be ServCo which "would have to compete for, win over, and assume all retail responsibility for a NetCo local customer in competition with other CLECs . . . ."[42] "ServCo would be allowed to offer all the services of a CLEC."[43] In LCI's view, ServCo would be a CLEC among CLECs and, therefore, it "would not bear the obligations of an ILEC under Sections 251 and 252 . . . ."[44]

LCI's proposed model, where NetCo becomes a wholesale supplier and ServCo becomes a retail vendor, would effectively eliminate resale as an avenue by which non-facilities-based providers can enter or continue to provide service in the local market. SNET's (Southern New England Telephone Company) corporate restructuring, under which it divided its formerly integrated operation into a wholesale entity[45] and a retail entity,[46] has been severely criticized because of the adverse consequences it has had for new entrants who seek to enter SNET's local

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[40] LCI Petition at 19, 23.

[41] Id. at 22.

[42] Id. at 15.

[43] Id. at 19.

[44] Id. at 20.

[45] SNET's wholesale entity is SNET-Telco which offers no retail telecommunications services to end-user customers.

market through resale. Even though SNET was not a BOC, it was regarded as an ILEC under the 1996 Act and it was subject to the duty to offer its end-user retail services at wholesale rates to resellers. However, after the SNET split, critics said:

> Indeed by discontinuing its offerings of all retail services and prices, SNET-Telco (which is a Section 251(h)(1) "incumbent local exchange carrier") can nonetheless effectively evade Section 252(d)(3), which requires that wholesale rates be set "on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier," simply by no longer having any "retail rates" from which avoided retailing costs can be removed.[47]

SNET-Telco, the wholesale entity, offers no retail services to end-user customers and, therefore, it offers no services which are subject to the resale duty in Section 251(c)(4). SNET America, the retail entity, offers retail services to end-user customers but it is regarded as a CLEC, not an ILEC, and therefore it is not subject to the resale duty in Section 251(c)(4).

LCI's proposal leads to the same result. NetCo would be regarded as an ILEC which would be subject to the resale duty in Section 251(c)(4); however, it would offer no end-user customer retail services which are subject to the resale duty. ServCo would offer end-user customer retail services, but it would not be subject to the resale duty in Section 251(c)(4), because it would not be regarded as an ILEC. Accordingly, resellers who were able to purchase local services at

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[46] SNET's retail entity is SNET America, Inc. SNET persuaded the Connecticut Department of Public Utilities Commission that its retail entity should be regulated as a newly-entering CLEC, rather than as an ILEC or an ILEC successor.

[47] The "Connecticut Experience" With Telecommunications Competition -- "A Case Study in Getting it Wrong," Economics and Technology, Inc. (Feb. 1998) at 32.

wholesale rates from the former integrated BOC before implementing LCI's proposal would be unable to purchase services at wholesale rates from either NetCo or ServCo, because NetCo would offer no services at retail which would be subject to the resale duty and because ServCo would not be subject to that resale duty at all.

Implementation of LCI's proposal would effectively eliminate resale as one of the three "essential" paths by which new entrants could enter or remain in the local market[48] and, understandably, resellers may regard this consequence of LCI's proposal as anticompetitive. Moreover, such a result would change the purposes sought to be achieved by Section 251 of the 1996 Act and would be in direct conflict with Congressional intent.

V. LCI'S PROPOSAL WOULD REQUIRE A BOC TO INCUR SUBSTANTIAL COSTS AND WOULD RESULT IN THE CREATION OF A HIGH-COST PLAYING FIELD

One of the stated objectives of LCI's proposal is to create a level playing field: "If adopted, the LCI 'Fast Track' proposal would promote vigorous retail competition by all telecommunications providers, across all telecommunications services, for residential as well as business customers, in all areas of the country, with the least regulation possible -- and would do so quickly," "in some states by the end of 1998."[49]

[48] On Feb. 26, 1997, LCI announced that it had signed a resale agreement with BellSouth: "LCI International Signs Regionwide Agreement with BellSouth to Offer Local Telephone Service," LCI World Wide Web Site. Ironically, if BellSouth were to implement LCI's proposal to separate its business into BellSouth NetCo and BellSouth ServCo, LCI's resale agreement with the formerly integrated BellSouth would probably be voidable and, as a result of the split, LCI would be unable to purchase local services at wholesale rates for resale in BellSouth's nine-state region.

[49] LCI Petition at 5.

Given the systems design and development effort which LCI's proposal would impose upon NetCo, discussed below, it is highly unlikely that LCI's projected timetable is realistic. Nevertheless, assuming that LCI's goals could be achieved in some states by the end of 1998, LCI's proposal would result in a high-cost playing field for CLECs and customers alike.

An efficient business structure integrates personnel, equipment, and facilities. The principal economic driver favoring integration is the reduction of costs. Structural separation results in higher costs and a more inefficient form of organizational structure. There are at least three major categories of costs resulting from structural separation of any business:

First, there are one-time separation costs associated with physically disrupting ongoing integrated operations, changing physical locations, modifying software and hardware equipment, search costs for new personnel, and disposing of excess capacity. Under LCI's proposal, because ServCo and NetCo could not share office building space, services, or facilities, office buildings and space currently occupied by the BOC would be underutilized after the split, requiring subleasing or complete relocation of both ServCo and NetCo. In addition, excess computer equipment and telephone equipment and cabling would remain in the vacated premises.

Second, day-to-day costs would increase as a result of the ServCo and NetCo split, because many of the same types of costs in performing the same functions would be incurred by both entities.[50]

Third, research and development ("R&D") costs would be higher and new product innovation would be slower, because technological synergies arising from joint R&D would be lost with the separation.

The costs resulting from structural separation are significant and will ultimately be borne by customers of all local providers. LCI does not attempt to disguise the fact that its plan will impose significant costs on NetCo, the provider of wholesale local services to ServCo and other CLECs. For example, it is LCI's belief that NetCo will be required to obsolete existing systems and replace them with new systems. Under its proposal, LCI says:

> The RBOC finally will have a direct incentive to design OSS systems of the highest quality possible, as rapidly as possible.[51]
>
> NetCo will be required to create and manage OSS systems and related "customer care" functions.[52]
>
> NetCo will be forced to develop systems which support competition in [the residential market].[53]

The development costs for these new systems will inevitably be passed on by NetCo to ServCo and other CLEC purchasers of its wholesale services, who will in

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[50] ServCo and NetCo would each incur costs as retail providers. LCI Petition at 15. ServCo and NetCo would each be obligated to offer exchange access and interconnection to other carriers. Id. at 19. Section 251(a), (b), and (c) obligations would apply to NetCo; Section 251(a) and (b) obligations would apply to ServCo. Id. at 20. ServCo and NetCo would both be liable for universal service assessments and both would be eligible to receive universal service funding. Id. at 23.

[51] Id. at 32 (emphasis added).

[52] Id. (emphasis added).

[53] Id. at 33 (emphasis added).